PILOT CARGO (M) SDN BHD & ANOR

v.

ADINAS TOURS & TRAVEL SDN BHD & ORS

HIGH COURT MALAYA, KUALA LUMPUR
KANG HWEE GEE J
[SUIT NO: D5-22-1409-2000]
7 JANUARY 2002

CIVIL PROCEDURE: *Writ of summons - Striking out - Action commenced on company's behalf - Whether proper procedure adopted to strike out action - Whether confined to tainted pleadings*

COMPANY LAW: *Directors - Powers of directors - Commencement of action on company's behalf - Whether within responsibility of managing director - Whether prevented by shareholders agreement - Whether director has implied power to act - Doctrine of agency of necessity - Whether applicable - Whether action commenced bona fide*

The plaintiffs alleged that the defendants had breached the terms of a letter of appointment issued by the 1st defendant to the 1st plaintiff. Subsequently, a writ of summons ('the said action') was filed against the defendants.

The defendants' application to the senior assistant registrar to strike out the said writ under O 18 r 19 of the Rules of the High Court 1980, on the premise that it was issued without authority, was dismissed. Hence, this appeal.

This court had to decide whether the 2nd plaintiff, who was the managing director and major shareholder of the 1st plaintiff, could commence and maintain an action in the name and on behalf of the latter, and whether he required the prior authorisation of its board of directors before doing so.

Held:

[1] A company can only act by delegating its power to its directors. Generally, the scope of that delegated power is defined under its articles of association. (p 448 b)

[2] A primary attribute of the corporate person is that it can sue and be sued. In the present case, the power of the 1st plaintiff to sue has to be exercised collectively by its directors under reg. 71. But under cl. 5.1 of the shareholders' agreement that was incorporated into the articles of association, the 2nd plaintiff had the responsibility of managing the daily operations of the company. In addition, there was nothing in the

articles of the shareholders' agreement which necessitated the act of commencing a legal action to be exercised by 1st plaintiff at a general meeting. Accordingly, the 2nd plaintiff was empowered to commence legal proceedings on behalf of the 1st plaintiff against the 1st defendant. (p 448 f-i)

[3] In the instant case, not only did the 2nd plaintiff have the implied power to act, but he had a duty to act under 'the doctrine of agency of necessity', as stated in the *Avel Consultant*'s case. It is a rule that directors must act *bona fide* in the interests of the company, more so, regarding the 2nd plaintiff as he was authorised to act alone on the company's behalf. However, there was nothing to suggest that the 2nd plaintiff acted in bad faith by instituting a civil action on the company's behalf to enforce its contractual rights under the contract. (p 449 a-i)

[4] Even if the act of commencing a legal action fell outside the daily operations of the company, the 2nd plaintiff by virtue of being the major shareholder could have passed a resolution to do so. (p 450 a-e)

[5] An O. 18 r. 19 procedure could hardly be applied to strike out a pleading merely on account of the fact that the director may not have the authority to commence an action on the company's behalf for the time being. Such a procedure is concerned only with pleadings which were in substance infirm, and not with those which were merely imperfect. (p 452 d-e)

[6] Where a challenge is made towards the authority of a party issuing the pleadings, this was normally resolved by granting a stay of proceedings to ascertain whether that party was authorised to do so and where appropriate to ratify any defects of authority that may arise. It should not be resolved by striking out the pleadings. (p 452 g-h)

[Defendants' appeal dismissed with costs.]

Case(s) referred to:

Alexander Ward and Co Ltd v. Samyang Navigation Co Ltd [1975] 2 All ER 424 ***(refd)***

Avel Consultants Sdn Bhd & Anor v. Mohd Zain Yusof & Ors [1984] 2 CLJ 169; [1984] 1 CLJ (Rep) 482 ***(foll)***

Danish Mercantile Co Ltd and Others v. Beaumont and Another [1951] 1 Ch 680 ***(refd)***

Marshall's Valve Gear Co Ltd v. Manning Wardle & Co Ltd [1909] 1 Ch 267 ***(refd)***

Pender v. Lushington [1877] 1 Ch D 70 ***(refd)***

Legislation referred to:

Rules of the High Court 1980, O. 18 r. 19

Other source(s) referred to:
Buckley, *Companies Acts*, 12th edn, p 169
Bullen & Leake and Jacob, *Precedents of Pleading*, 12th edn, p 143
Chan & Koh, *Company Law*, p 6.101
Gower's Modern Company Law, 3rd edn, pp 136, 137

For the plaintiffs - CW Teo; M/s Khaw & Partners
For the defendants - S Nantha Balan; M/s Shook Lin & Bok

Reported by M Maheswaran

JUDGMENT

Kang Hwee Gee J:
This is an appeal from the decision of the senior assistant registrar dismissing the defendants' application to strike out the writ of summons of a company under O. 18 r. 19 of the Rules of the High Court 1980, by reason that it was issued without its authority.

The Facts
The 1st plaintiff is a private limited company. The 2nd plaintiff is its managing director and majority shareholder holding 51% of its shares. The remaining 49% of its shares is held by the 2nd defendant.

The plaintiffs and the 2nd defendant are bound by the terms and conditions of a shareholders' agreement which they entered into on 15 March 1999 and which *inter alia* provides that the board of directors of the 1st plaintiff determines the general policy of the 1st plaintiff including the scope of its activities and operations and that it reserves to itself all matters involving major or unusual decisions.

The shareholders' agreement was incorporated into the articles of association of the 1st plaintiff to give effect to the agreement reached between the parties in the agreement.

On or about 28 July 2000, the plaintiffs filed a writ of summons against the defendants for *inter alia*, declarations, injunctions, an order for accounts and damages based on an alleged breach of the terms of a letter of appointment dated 2 October 1998 issued by the 1st defendant to the 1st plaintiff.

The Grounds
It is contended by the defendants:

(i) that the commencement of this action in the name of the 1st plaintiff against the defendants constitutes a major or unusual decision, such that, it requires the prior authorisation or approval of the 1st plaintiff's board of directors pursuant to the shareholders' agreement and the articles of association of the company;

(ii) that the commencement of this action by the 2nd plaintiff as the managing director of the company was done without any resolution or any written instruction or directive of the board of directors of the company, and was therefore contrary to the said shareholders' agreement and the articles of the company;

(iii) that the 2nd defendant had in fact all along taken the position and notified the 2nd plaintiff that no legal action should be commenced and that he would arrive in Malaysia in mid-August 2000 to discuss all outstanding disputes and have all matters resolved amicably;

(iv) that the company secretary of the 1st plaintiff has confirmed that no directors or circular resolution has been passed by the board of directors of the 1st plaintiff authorising the commencement of any action against the 1st defendant or other individuals.

In the event, it is contended, the action commenced by the 1st plaintiff's company against the defendants was without legal authority and should be dismissed with costs to be paid by the 2nd plaintiff or his solicitors from their own pockets.

The Operative Provisions Of The Shareholders' Agreement And The Articles Of Association

In order that the intervenor's application may be properly appreciated, one has to be acquainted with the operative provisions of both the shareholders' agreement and the articles of association of the 1st plaintiff. The respective provisions are as follows:

Shareholders' Agreement dated 15 March 1999

The parties to the agreement were:

(1) Chiam Toon How (Singapore NRIC No. 1789921Z) of No. 2, Li Hwan Close, Singapore 557126 (hereinafter referred to as "HC") of the first part;

(2) Ahmed Salem Mohammed Shammakh (Yemen Passport No. 00149643) of Ground Floor, Menara PanGlobal, 8 Lorong P. Ramlee, 50250 Kuala Lumpur (hereinafter referred to as "ASMS") of the second part; and

(3) Pilot Cargo (M) Sdn Bhd (company No. 455997-T) whose registered office is at 68-3, Wisma PK1, Jalan Loke Yew, 55200 Kuala Lumpur (hereinafter referred to as "the company") of the third part.

Clause 4.2

Each of the shareholders shall be entitled to appoint two directors and at any time to require the removal or replacement of either or both of the directors. The directors appointed by HC (including those appointed under cl. 3.1.4) shall be designated as 'A' directors and the directors appointed by ASMS (including those appointed under cl. 3.1.5) shall be designated as 'B' directors.

Clause 5.1

The responsibility of the day to day management of the company shall rest on HC. The shareholders shall exercise all rights available to them in relation to the company and HC and the company shall do everything necessary to procure (so far as they are able to do so) that during the term of this agreement.

Clause 5.1.9

Notwithstanding anything to the contrary hereincontained but subject to cl. 17, no resolution of the board on any matter shall be passed or take effect unless at least one 'A' director and one 'B' director have voted in favour of the resolution.

The Articles of Association

Regulation 46

No business shall be transacted at any general meeting unless a quorum of members is present at the time when the meeting proceeds to business. The quorum for all general meetings of the company (including annual general meetings) shall be the presence (either in person, by proxy or as representative) of:

(iii) HC; and

(iv) ASMS.

Regulation 53

Subject to any rights or restrictions for the time being attaching to any class of classes of shares, at meetings of members or classes of members each member entitled to vote may vote in person or by proxy or by attorney and on a show of hands every person present who is a member or a representative of a member shall have one vote, and on a poll every member present in person or by proxy or by attorney or other duly authorised representative shall have one vote for such share he holds.

Regulation 63

For so long as HC and ASMS are members of the company, the company shall have a board of directors consisting of four directors made up as follows:

Two nominees of HC

Two nominees of ASMS

Regulation 71

The business of the company shall be managed by the directors who may pay all expenses incurred in promoting and registering the company, and may exercise all such powers of the company as are not, by the Act or by these regulations, required to be exercised by the company in general meeting,

subject, nevertheless, to any of these regulations, to the general meeting; but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made.

Regulation 78
Notwithstanding anything to the contrary hereincontained but subject to the provisions in the agreement, no resolution of the board on any matter shall be passed or take effect unless at least one director nominated by HC and one director nominated by ASMS have voted in favour of the resolution.

Regulation 87
The directors may from time to time appoint one or more of their body to the office of managing director for such period and on such terms as they think fit and, subject to the terms of any agreement entered into in any particular case, may revoke any such appointment. A director so appointed shall not, while holding that office, be subject to retirement by rotation or be taken into account in determining the rotation of retirement of directors, but his appointment shall be automatically determined if he ceases from any cause to be a director.

Regulation 89
The directors may entrust to and confer upon a managing director any of the power exercisable by them upon such terms and conditions and with such restrictions as they may think fit, and either collaterally with or to the exclusion of their own powers, and may from time to time revoke, withdraw, alter, or vary all or any of those powers.

Can The 2nd Plaintiff Commence This Action On Behalf Of The Company?
The question whether the 2nd plaintiff may commence this action in the name and on behalf of the company and whether he must first obtain a resolution of the board of directors authorising him to do so, would have to be resolved by applying that aspect of company law pertaining to the power of directors to act for the company.

I would not however, be treading on unfamiliar territory for the same issue had been considered by VC George J in *Avel Consultants Sdn Bhd & Anor v. Mohd Zain Yusof & Ors* [1984] 2 CLJ 169. The judgment was much heralded for originality in its application of the 'doctrine of agency of necessity', the contextual relevance of which I shall refer to shortly.

Going By The Articles Of Association Of The Company
The limitation of the corporate person is well described by the authors of Chan & Koh's *Company Law*, at 6.101 of their work:

> A company being a fictitious persona 'cannot act in its own person, for it has no person'. Any proposition about a company necessarily involves a reference to a set of rules by which acts are attributed to the company. This set of rules has been described as the 'rules of attribution' which are said to contain the 'primary rules of attribution' and 'general rules of attribution'. A company being a *persona ficta* may only act through the agency of natural persons.

Being an artificial person therefore, a company can only act by delegating its power to its directors. Generally the scope of that delegated power is defined under its articles of association. In a company that adopts table A of the 4th schedule, this is to be found in art. 73:

> 73. The business of the company shall be managed by the directors who may pay all expenses incurred in promoting and registering the company, and may exercise all such powers of the company as are not, by the Act or by these regulations, required to be exercised by the company in general meeting, subject, nevertheless any of these regulations, to the provisions of the Act, and to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting; but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made.

The 1st plaintiff in this case has its own articles of association. The powers that it delegates to its directors is contained in reg. 71 of its articles and read as follows:

> The business of the company shall be managed by the directors who may pay all expenses incurred in promoting and registering the company, and may exercise all such powers of the company as are not, by the Act or by these regulations, required to be exercised by the company in general meeting, subject, nevertheless, to any of these regulations, to the general meeting; but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made.

A primary attribute of the corporate person is that it can sue and be sued. The power of the 1st plaintiff to sue has to be exercised collectively by its directors under reg. 71. But cl. 5.1 of the shareholders' agreement which has now been incorporated into its own articles of association, provides that the "responsibility of the day to day management of the company shall rest with HC", that is to say, the 2nd plaintiff.

Much as I endeavour, I am unable to find any such provision anywhere in the articles or the shareholders' agreement that requires the act of commencing a legal proceeding "to be exercised by the company in a general meeting".

I am therefore constrained to find that the 2nd plaintiff was perfectly empowered to commence legal proceedings against the 1st defendant on behalf of the company.

Assuming That The Managing Director Is Unsure Whether He Can Act It was held in *Avel Consultants Sdn Bhd & Anor v. Mohd Zain Yusof & Ors* [1984] 2 CLJ 169; [1984] 1 CLJ (Rep) 482, a case directly on point – that not only a director in the same position and finding himself in the same circumstances as the 2nd plaintiff in the instant case had the implied power to act, but had a duty to act under 'the doctrine of agency of necessity'. This was what VC George J (as he then was) said in that judgment:

> It seems to me that the doctrine of Agency of Necessity is not without application in this case. In *Halsbury's Laws of England* 3rd Edn. Vol. 1 page 157 at paragraph 373 deals with the application of the doctrine, portions of which read as follows:
>
> > Agency of necessity arises wherever a duty is imposed upon a person to act on behalf of another apart from contract, and in circumstances of emergency, in order to prevent irreparable injury. It may also arise where a person carries out the legal or moral duties of another in the absence or default of that other, or acts in his interest to preserve his property from destruction.
> >
> > The conditions which entitle an agent to exceed his authority under the doctrine of necessity are (1) that he could not communicate with his principal; (2) that the course he took was necessary in the sense that it was in the circumstances the only reasonable and prudent course to take; and (3) that he acted *bona fide* in the interest of the parties concerned. At the same time, though a strong case is required, it is not essential that any other course shall be an impossibility.
> >
> > In my judgment in the absence of express limitations to the contrary, the managing director of a company has the implied authority to commence legal proceedings in the name of the company. I would go so far as to say that where the situation is such that the reasonable and prudent course to take was to go to Court then in fact the managing director could be defaulted for not having done so.
> >
> > The position is that in respect of a managing director of a company apart from an implied term in his contractual relationship with the company the doctrine of Agency of Necessity would impose a duty on him to act on behalf of the company, and if necessary even to commence legal proceedings in the name of the company, to preserve the property of the company.

Directors must of course act *bona fide* in the interest of the company. That rule binds the 2nd plaintiff in as much as it binds the board of directors as in this case he is authorised to act alone on behalf of the company. He can hardly be accused of not acting *bona fide* in the interest of the company when he acted on behalf of the company to institute the civil action to enforce its contractual right under a contract.

Assuming That A Resolution Is Required

Assuming that the decision to commence a legal action falls outside the day to day running of the company (as the defendants are apt to argue), making that decision would still have to fall on the lap of the board of directors of the company under reg. 71. And again assuming that there is a deadlock by reason that the resolution is prevented from being carried through by reg. 78 (which requires that both the votes from the nominee of the 2nd plaintiff and the nominee of the 2nd defendant must be in favour of the resolution), the decision would ultimately have to be brought before a general meeting of the company. This course of action has to be resorted to based on the principle that it is the majority vote of the company in general meeting that has the ultimate say in matters pertaining to the business of the company. As the learned author of *Gower's Modern Company Law* (3rd edn) said at pp. 136, 137 of his work:

> It seems that if for some reason the board cannot or will not exercise the powers vested in them, the general meeting may do so. On this ground, action by the general meeting has been held effective where there was a deadlock on the board, where an effective quorum could not be obtained, where the directors are disqualified from voting, or, more obviously, where the directors have purported to borrow in excess of the amount authorised by the articles.

By reason of the 2nd plaintiff having a 51% equity in the company with a proportionately superior number of votes, a resolution to commence legal action against the 1st defendant could have been passed to put the 1st plaintiff on a firm authoritative footing. The law with respect to the ratification of the acts of directors in company law is well settled. Two well known English cases may be cited as providing the authority to that principle.

In *Danish Mercantile Co Ltd and Others v. Beaumont and Another* [1951] 1 Ch 680, the Court of Appeal had to decide whether an action commenced without authority in the name of the plaintiff's company by its solicitor ought to be struck out. It was held that the act of the solicitor may be ratified by the company later to cure the defect and that it would not then be open to a defendant to object that the proceedings then ratified and adopted were in the first instance brought without authority Jenkins, LJ referred to and approved the following passage in Buckley on the *Companies Acts* (12th edn), p. 169 which in his view correctly summarised the law:

> If the case be one in which the company ought to be the plaintiff, the fact that the seal is in the possession of the adverse party will not necessary preclude the intending plaintiffs from using the company's name. Neither will it be necessary to obtain the resolution of a general meeting in favour of the action before the writ is issued. In many cases the delay might amount to a denial of justice. In a case of urgency, the intending plaintiffs may use the company's name at their peril, and subject to their being to show that they have the support of the majority. In an action so constituted, the court may

give interlocutory relief, taking care that a meeting be called at the earliest possible date to determine whether the action really has the support of the majority or not.

In the later House of Lords' case of *Alexander Ward and Co Ltd v. Samyang Navigation Co Ltd* [1975] 2 All ER 424, their Lordships had to decide whether the arrestment of a ship instituted before the court of sessions in Scotland by a company was brought validly. At the time it was instituted the company had no directors as it failed to conduct any general meeting to elect them. The act of the company was however subsequently ratified by the liquidator of the company when it folded and went into liquidation. It was held that although no directors had been appointed to manage the company, it did not follow that the company was unable to exercise its powers of management. Any act within the company's power could still be undertaken on its behalf and ratified by the company at a later date. The following passage from the speech of Lord Morris of Borth-Y-Gest at p. 426 lines h and j, provides the rationale for the decision:

> Is there then any reason why ratification could not take place? In agreement with Lord Kissen and Lord Fraser it seems to me that the arrestment to found jurisdiction was an essential part of or a preliminary step in the raising of the action. If as the action proceeds it is said to the company that those who in the name of the company obtained the summons of 5th November 1970 and acted on it, lacked at the time the authority of the company, it seems to me that it is clearly open to the company to say that they fully adopt all that was done. If something which at the time when it is done is done without authority but is done in the name of and in the purported capacity as an agent for a principal who later ratifies all that was done the ratification relates back: retrospectively it clothes what was done with authority. I agree therefore with Lord Fraser when he said that if arrestment is properly regarded as a preliminary step in the action itself then the ratification of the action will draw back and will retrospectively validate the arrestment in the same way as it validates the rest of. the action.
>
> I would dismiss the appeal.

An even clearer rationale why a writ commenced without the authority of the company but which nevertheless has the blessings of the majority of its shareholder is not liable to be struck out is to be found in the judgment of Nevillel J in *Marshall's Valve Gear Co Ltd v. Manning Wardle & Co Ltd* [1909] 1 Ch 267 when he dealt with a similar situation in which the managing director who had caused the writ to issue controlled the majority of the shares of the company. This was what Neville J said at p. 272 of his judgment when he disallowed the application:

> ... Mr. Marshall has commenced an action in the name of the company for the purpose of restraining an alleged infringement on the part of the owners of the new patent, and the other directors come to the Court and ask to have the writ in that action taken off the file on the ground that the action was

commenced without the authority of the company. It is admitted that the calling of a meeting of shareholders to ascertain the wishes of the company would be useless because the position of the voting power is perfectly well understood. It is divided between the persons concerned, and undoubtedly the managing director, who has commenced this action, would have the majority of votes at a general meeting, and, therefore, if it is right that effect should be given to the wishes of the majority of the company in the present case, it is admitted that no object is to be gained by calling a meeting, because the result of that meeting is a foregone conclusion. Under those circumstances ought the Court to direct the removal of the writ?

Striking out?

Striking out an opponent's pleading summarily under an O. 18 r. 19 procedure is a drastic step the effect of which is to shut him out from the court without hearing a word of what he has to say. Unless the pleading is plainly unsustainable, the application will fail – and obviously any action which may initially have been commenced without the decisive authority of its board of directors but which nevertheless may later be approved and ratified by its members is not an action which is plainly unsustainable. (See *Malaysian High Court Practice* 1998 Desk Edition at 18.9.1 and the cases cited therein.)

An O. 18 r. 19 procedure could hardly be applied to strike out a pleading merely on account of the fact that the director may not have the authority for the time being, to commence an action on behalf of the company. The summary procedure under O. 18 r. 19 is concerned only with pleadings which are in substance infirm and not with those which are merely imperfect. The rule is of some antiquity but is still current and may be understood properly by referring to the following passage in the 12th edn of Bullen & Leake and Jacob's *Precedents of Pleading*, at p. 143:

> Thus, where the statement of claim or defence appears to disclose no reasonable cause of action or defence because some material averment has been omitted or because the pleading is defectively stated or formulated, the court while striking out the pleading will not dismiss the action or enter judgment, but will give the party leave to amend and if necessary to serve a fresh pleading to correct or cure the defects that appear in the original pleading.

Where a pleading is challenged with respect to the authority of its issuer, the court has always resolved it by granting a stay of the proceeding in order to allow the company to determine the question of whether he had been authorised to commence the proceeding and where appropriate to ratify any defects of authority that may arise (*Pender v. Lushington* [1877] 1 Ch D 70). It should not be resolved by striking out the pleading.

There is hardly any merit in this application. The registrar was right in dismissing it with costs.

The appeal is dismissed with costs.